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Select Committee on Gasoline Competition, Marketing, and Pricing

**Developing a Strategic Approach to Affordable
and Stable Prices at the Pump**

Staff Report

**Wednesday, August 27, 2003
Room 447, State Capitol, Sacramento**

Prepared by Michael Müller
and Alicia Priego

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I. Introduction

This report provides basic information for a discussion of gasoline and diesel prices in California at a hearing of the Assembly Select Committee on Gasoline Competition, Marketing, and Pricing. This report discusses the following issues:

- The Current Situation
- History of Gasoline Prices
- A Discussion of the Industry
- CARB Gasoline, MTBE, and transition to summer gasoline in California
- Factors Effecting Fuel Prices
- Differences Between California and the Rest of the Nation
- Legislative History
- Current Legislation

These issues will be addressed in more detail by testimony at the committee hearing.

NOTE: This document is intended only as a general summary of differing views on gasoline pricing in California and related issues. This is not a research document, and staff have been unable to independently verify all assertions or evaluate the viewpoints included. While staff has made every effort to verify data presented and identify sources, in many cases the parties have offered differing sets of data and differing conclusions related to the same market or industry issue. Nevertheless, the information included should provide an outline of the issues in contention and the viewpoints of industry, consumer groups, and gasoline retailers on the key issues under discussion.

II. Summary

The Senate Energy, Utilities & Communications Committee analysis of SB 304 (Morrow) offered an overview discussion of the issue. Please see Appendix #1.

High & Unstable Prices?

In examining the subject of this hearing, the first question raised might be, "Are gasoline prices high and unstable?" While media accounts have reported at length about California's volatile and upward spiraling prices at the pump in 2003, some in the oil industry have argued that California's prices are really not that high. Additionally, if prices are unstable, it is not because of profit seeking or price gouging, but only because of market forces and long a list of variables that are difficult to predict or control.

Californians are again paying more than \$2.00 per gallon at the pump. Consumers have expressed outrage. The real world effect of this increase on the average motorist amounts to substantial out of pocket costs. According to the California Service Station and Automotive Repair Association the increase in gas prices in August alone is costing California drivers an extra \$10.7 million each day.

However, the oil industry asserts that when one looks at the price of gasoline over the last 30 years, prices have only kept pace with inflation. In recent years, prices, which averaged in the \$1.50 range, were well below what they would be if prices were adjusted annually to reflect the consumer price index. When comparing prices in 1970 to prices in 2001, the industry found that 1970 prices and 2001 prices were nearly the same when adjusted for inflation.

Additionally, other economists argue that California's prices, and prices in the United States, are very low when compared to other parts of the world. In Europe, prices are often double what they are in the United States. This is in large part because of surtaxes charged at the pump to fund transportation projects.

Consumer groups argue that every business that transports a product and every California motorist is paying far too much for gasoline. Our prices are higher than the rest of the nation. Additionally, parts of California are paying much more for gasoline than other parts of the state. Retailers have long argued that zone pricing policies have caused gasoline purchased in Beverly Hills to be cheaper than gasoline purchased in communities with high unemployment and economic challenges. Prices in Sacramento are consistently lower by several cents per gallon than prices in San Diego or in San Francisco, which is located in close proximity to refineries.

Potential Causes for Increased Price and Instability

If one concludes that prices are indeed too high and are unstable, the next question is, "Why?" This question will bring forward varied and polarized responses from the industry, consumer advocates, and regulators. Below are some of those responses:

- Consumer advocates argue there is no competition in the marketplace. The oil industry in California is an oligopoly. Only seven oil companies control 96% of the gasoline sold in California. Additionally, oil companies are operating more retail outlets themselves and the number of retail outlets is dropping substantially. Where there is reduced competition, higher prices are commonly the result in most retail products.
- The oil industry contends that competition is not the problem. But even if it were, it is difficult to increase competition, given the structure of the industry, without driving up costs. Efforts to create more independent retail outlets and give retailers greater flexibility in purchasing fuel will not increase competition.
- The oil industry further argues that California's environmental protection laws are too tight. Consequently, oil companies cannot open enough refineries to meet demand. Additionally, these laws require the use of a California-only blended fuel, which increases costs substantially.
- Consumer advocates believe that California's environmental protection laws are not the problem. Other states have similar special mixes of fuel and do not experience such high prices. The number of refineries is sufficient to meet our needs, which is evidenced by the fact that California exports refined fuel and that our refineries seldom if ever run at capacity.
- Retailers state that oil companies selectively, subjectively, and arbitrarily set prices to retailers through a zone pricing policy that gouges retailers and consumers. This is the reason that gas stations near airports charge higher prices. It is also the reason why gas stations located near refineries charge more than gas stations 100 miles from the nearest refinery. Zones can be as large as a city or as small as a street corner.
- Industry analysts have argued that Californians drive too many SUV's and other gas guzzling vehicles. This increases demand and drives up prices. If Californians were truly concerned about high prices, they would drive more fuel-efficient vehicles.
- According to California Energy Commission data, California is 41st in the U.S on per capita fuel use. In 40 other states, motorists use more fuel per capita than California.
- The oil industry contends that gas prices rise very quickly at times, but only in response to specific conditions or occurrences – A refinery shut down, a pipe breaks in Arizona, a conflict arises in the Middle East, etc. Each of these can create great supply and demand problems.
- Consumer advocates and regulators argue that while prices rise quickly, allegedly in response to a specific condition or occurrence, prices do not come down nearly as quickly. Historically, prices "rise like a rocket, but come down like

a feather.” For example, a three-week price spike may take six months to come back down.

- The oil industry has argued that California prices are too high, in part, because California taxes at the pump are far too high.
- Consumer advocates, regulators, and retailers believe that high California prices have nothing to do with taxes. Many states have taxes far and above California’s taxes, yet have lower gas prices.

Conclusions

All parties make interesting points when identifying the reasons for high gas prices. It is difficult to review the entire body of evidence and recognize a clear and conclusive reason for high and unstable prices. However, certain facts do appear to deserve consideration and evaluation:

- In California competition is arguably seriously lacking at all levels in the industry.
- In recent months, prices have been very volatile.
- California has a similar tax level to other states and similar fuel mixture requirements, yet California prices are much higher than other states.
- On average, motorists are driving vehicles that are less fuel-efficient than they were 10 years ago. In the 1970s and early 1980s motorists purchased more fuel-efficient vehicles. However, in the late 1980s and 1990s and into the 21st Century, the sales of larger SUVs and less fuel-efficient vehicles increased. Consumption has increased with this trend.
- Based on aggregate data, refinery margins in 2003 were estimated by the California Energy Commission to be as high as 68 cents per gallon. This is almost 75% higher than the margins in 2002. Additionally, in the first quarter of 2003 when gasoline prices were at a record high, ExxonMobile enjoyed a record profit of \$7 billion.

III. The Current Situation

According to a CNN News story on August 25, 2003:

Gas prices zoomed at a record pace during the past two weeks, increasing by more than 15 cents per gallon to a national average of \$1.72, according to a national survey of gas stations.

That was the largest two -week rise in the half-century history of the Lundberg Survey, Publisher Trilby Lundberg told CNN.

Still, the price was a penny shy of the all-time high, set on March 21, she said.

Lundberg said panic buying in Phoenix, Arizona, after a pipeline burst August 8, cutting supplies to the area, caused prices there to soar 60 cents per gallon, to \$2.12. Phoenix consumers paid the most in the nation for gasoline, according to the survey.

Energy officials in Arizona say the pipeline has been repaired and gas is flowing into Phoenix again, though they say it may take a few days for it to reach the city, according to The Associated Press.

The rupture affected prices all along the West Coast, driving the average cost of a gallon of gas in Los Angeles up 42 cents, to \$2.06.

Refinery shutdowns caused by last week's blackout that affected parts of the East and Midwest also played a role in the price jump, she said.

The survey of prices at about 7,000 gas stations was carried out August 8 and Friday. Drivers in Charleston, South Carolina, paid the least, at \$1.49, according to the survey.

Lundberg said the pipeline's repair and the drop in demand that typically occurs at summer's end would likely send prices lower in coming weeks.

In the August 20 edition of This Week in Petroleum, The Energy Information Administration's (EIA) reports the following:

The EIA's weekly survey of retail gasoline prices showed that prices increased by 5.6 cents per gallon nationally from August 11 to August 18. Prices in the West Coast region (Arizona, Nevada, California, Oregon, Washington, Alaska, and Hawaii) rose by 17.3 cents per gallon, the second largest regional increase the EIA has ever recorded on its weekly survey (regional weekly retail prices have been gathered since May 1992). (The only other week which showed a larger regional increase was on March 29, 1999, when West Coast prices rose by 18.1 cents per gallon, going from \$1.184 to \$1.365 per gallon.)

A price jump of this magnitude is a clear indication of significant problems with supply, and, in fact, this is the case. Besides some unplanned refinery outages in California, and earlier in the month a refinery outage in Washington, a pipeline via Tucson from the East that supplies about 30 percent of the gasoline used in Phoenix was shut down completely as of August 8 due to a rupture in the pipeline that occurred on July 30 (it had been flowing at a dramatically reduced rate immediately following the rupture). The result was to pull additional gasoline supplies from California, which already had tight supplies.

But with many gasoline stations in Phoenix reportedly completely out of gasoline, prices increased dramatically for those stations that did have supply (there is one report that a gasoline station in Phoenix was charging \$3.89 per gallon for gasoline at one point), causing additional supplies to come from

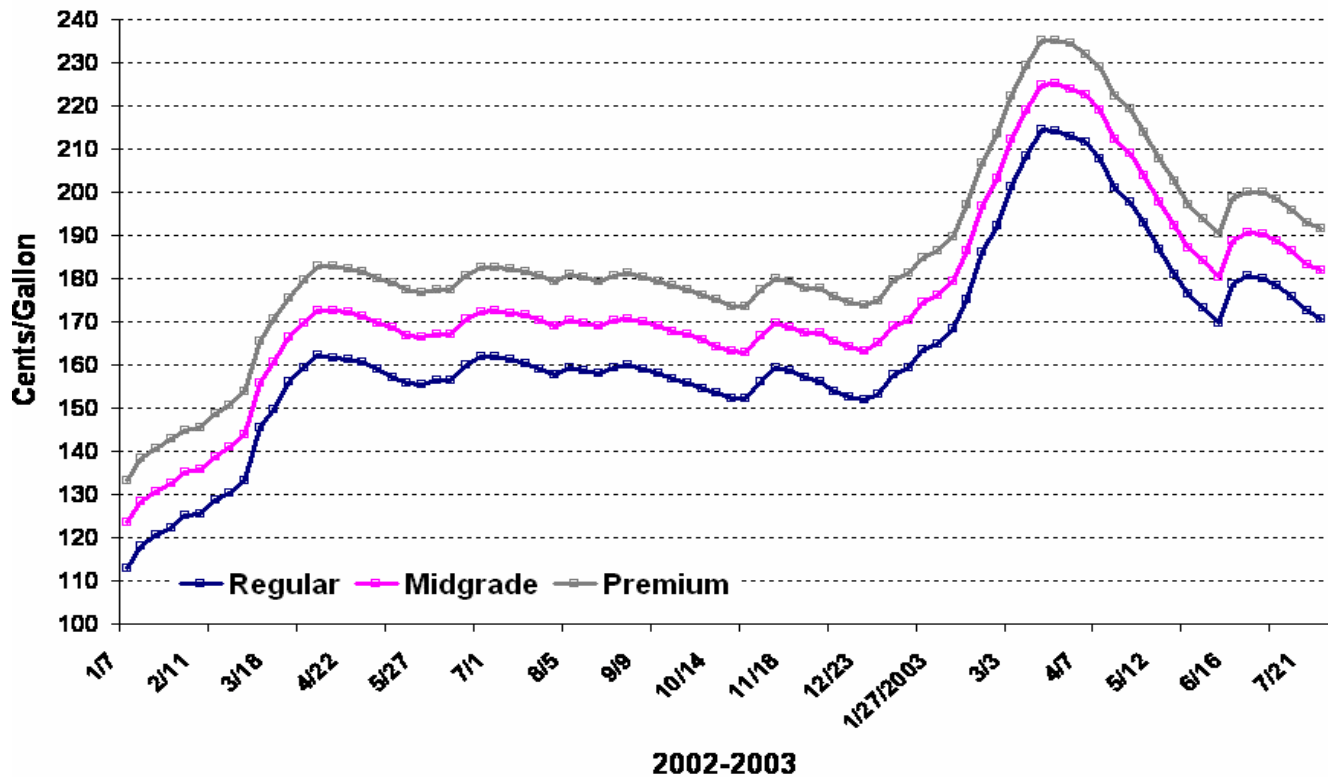
places like California that would likely be drawing additional supplies itself, had the product pipeline into Arizona not shut down.

This, in turn, has reduced gasoline supplies in California. Given California's role as the dominant state in the West Coast gasoline market, this impact has spilled over to most of the region (excluding Alaska and Hawaii). Similar to electricity, the interconnectedness of gasoline markets means that a problem in one part of the country can ripple across a wide area.

But there is some good news to report. Testing on the portion of the pipeline between Tucson and Phoenix has been approved and if all goes well, the pipeline may be able to reopen sometime this weekend. This would enable additional gasoline supply to enter Phoenix, but it will take some time before markets return to normal in the West Coast region, as suppliers will be attempting to bring supplies back up to normal levels. With the Labor Day weekend less than 2 weeks away, gasoline prices are likely to rise even further on a national basis, as recent increases in wholesale prices continue to be passed through to retail markets. However, prices should ease in September, as high prices will generate additional supplies just as demand falls off following the end of the summer season.

IV. History of Gasoline Prices

Figure 7
California Statewide Average Retail Gasoline Prices



(As of 7/28/2003)

Source: Energy Information

For the past eight years, California consumers and businesses have been paying much higher prices for gasoline than consumers in the rest of the United States, regardless of whether crude oil prices are rising or falling.

- Until the mid-1990s, before CARB requirements were in place, gasoline prices in California were within a few cents of the national average and in some years, were actually lower than the national average;
- Since 1995, Californians have paid more than the national average in 381 out of 433 weeks;
- Since June 2000, California motorists have paid a combined \$5.8 billion more for gasoline than other areas that use reformulated gasoline;
- In 2002, California drivers paid an average of 12 cents more per gallon for gasoline, adjusted for taxes, than drivers in other states, according to the U.S. Department of Energy;

- Businesses, which consume approximately one-third of the gasoline in California each year according to the California Energy Commission, pay an annual premium of \$638 million more for gasoline each year than businesses in the rest of the country; and
- In 11 California cities in April 2003, gasoline was more expensive than in Honolulu, Hawaii.¹

As in the current situation, the oil industry has claimed that insufficient refining capacity, restrictive environmental standards, growing gasoline demand and OPEC production cutbacks are the primary reasons for the oil and gas supply problem. However, recent research findings have found that the price ratchet may result from a combination of inadequate capacity and inadequate competition in the industry. The market condition has been the result of both increasing demand and business decisions that slowed the growth of long-term capacity.²

Supply and Demand

California is the nation's fourth-largest producer of crude oil, producing 800,000 barrels a day. There are 22 refineries in California. Of those 21 are operational, and 13 are major refineries that supply fuel to retailers. The state's 13 refineries, after importing 1.2 million barrels of crude, produce about 37 million gallons a day. California consumes more than 42 million gallons of gas every day and the demand keeps increasing annually.³

According to a 2002 report of the National Petrochemical and Refiners Association, California refineries have the capacity to refine about 1/8 of all the crude oil refined annually in the United States. California's 21 operational refineries compare to no refineries in Arizona, 2 in Nevada, 1 in Oregon, and 5 in Washington.

In 2002, only Texas had more refineries than California with 25. However, Texas refined more than twice the amount of crude oil as California's 21 refineries in the same period.

There have not been any new refineries being built or opened in California in about 30 years. Few Californians would choose to live in close proximity to a refinery. Californians are concerned about environmental hazards, potential industrial accidents, reduced property values, environmental justice, and the general stigma associated with refineries.

The oil industry has argued that regulatory requirements, cost of compliance with regulatory hurdles, and other environmental concerns have created a barrier to building new refineries.

¹ California Service Station and Automotive Repair Association, *The California Gasoline Crisis*, pg 1

² Investigative report presented by Senator Ron Wyden, [The Oil Industry, Gas Supply and Refinery Capacity: More than Meets the Eye](#)

³ Douglass, Elizabeth, "State Considers Establishing a Gasoline Bank" Los Angeles Times March 24, 2003

However, California is not alone in this. The last three refineries built in the United States were all built in the early 1970's. They were in Louisiana, Benicia, CA, and Cherry Point, WA.

California clearly has a limited supply. As long as demand for gasoline continues to grow, California's gasoline supply will be subject to price spikes. The Consumer Federation of America states,

*"Because automobiles and driving are necessities, not luxury goods, people buy a certain amount to meet their daily needs, but they do not consume much more beyond meeting those needs. Because the price elasticity is low, consumers have difficulty substituting for this commodity when its price increases."*⁴

Findings by the Consumer Federation of America, the Attorney General, and the California Energy Commission reveal that there are two clearly identifiable trends affecting the supply side of the gasoline market – a reduction in capacity relative to demand and an increase in concentration.⁵

Under current circumstances, petroleum production falls short of expectations and prices rise to ration the limited supplies, and to provide an incentive to industry to increase out of state sources of supply.⁶

Even at maximum production, the state still needs to import an estimated 100 million gallons of gasoline and blend stocks each month to meet California's demand. This demand creates additional pressures and vulnerabilities to price spikes.

Energy economist Phillip Verleger, a leading authority on energy commodity markets including oil, natural gas and electricity, points out that low inventories have important economic consequences on petroleum markets. Verleger suggests that refining inputs have followed a normal pattern and that other factors explain the low inventories, such as:

- The threat posed by the federal strategic petroleum reserves, comprising 33% of all domestic stocks. A decision to use these stocks could reduce crude prices precipitously and inflict losses of \$10 per barrel and as much as a \$10 billion paper loss on refiners.
- The high cost of hedging incremental crude purchases. Verleger places these costs at \$2.50 per barrel, or 10 cents per gallon, compared to a 17-year average of 20 cents per barrel.
- The poor financial condition of many refiners, making it difficult to acquire inventories in these market conditions. Refiner margins were poor in 2002 and downgrading of debt by rating agencies has raised the cost of money. Verleger

⁴ Consumer Federation of America, Ending the Gasoline Price Spiral, pg 14

⁵ Consumer Federation of America, Ending the Gasoline Price Spiral, iii

⁶ California Energy Commission, Causes for Gasoline & Diesel Price Increases in California, 9

states that these financially weakened companies account for 30% of the US refining capacity.

According to California Service Station and Automotive Repair Association, gasoline prices have increased at the wholesale level by \$.26 per gallon since July 31, 2003.

California consumes approximately 15 billion gallons of gasoline each year, or 41 million gallons each day. This consumption rate multiplied by the increase equals \$10.7 million in extra costs to California drivers and businesses each day.

According to the Consumer Federation of America:

"Market fundamentals (inadequate capacity and inelastic supply and demand), market structures (ownership concentration and vertical integration), corporate conduct (capacity and production decisions), and market performance (price and profits) all point toward the potential for the abuse of market power." ⁷

V. The Industry

According to information provided to the committee by Automotive Trade Organizations of California, second quarter 2003 oil company profits are as follows:

BPARGO: First six month profits for 2003 were \$6.84 billion up 81% from \$3.8 billion the first six months of 2002. Refining & marketing earnings for 2003 were \$1.99 billion, up 200% from \$972 million the year before, owing primarily to worldwide refinery margins and higher marketing margins, particularly retail margins in the USA.

ChevronTexaco: Second quarter 2003 earnings were up 393% to \$1.6 billion, compared with \$407 million in the same period in 2002. Refining & marketing earnings for 2003 were up 217% to \$187 million compared to a loss of \$30 million one year ago. The primary reason for the improvement was a recovery in the industry's West Coast refined product margins.

ConocoPhillips (76 brand): Second quarter earnings were up 324% to \$1.138 billion compared to \$351 million one year ago. Refining & marketing earnings was \$301 million up 442% from earnings one year ago of \$68 million. The merger with Conoco, higher sales volumes, refinery and marketing margins in the U.S. and international markets led to these increases.

ExxonMobil: Net income for second quarter 2003 was \$4.17 billion up 158% from one year ago \$2.64 billion. Refining & marketing earnings for the same period were \$1.15 billion up 150% from 2002's \$764 million. Margins were particularly strong at the beginning of the quarter." U.S. downstream earnings were \$419 million up 226% from 2002's \$185 million.

⁷ Consumer Federation of America, 25

RDSShell: Net income for second quarter 2003 was \$2.83 billion up 28% from \$2.2 billion. World wide oil products (refining & marketing) 448 million in 2003 compared to \$444 million in the same period in 2002.

Retailers and consumer advocates contend that given the national economic downturn, it is troubling to see such increased profits while small businesses and workers are struggling and paying record high prices at the pump.

However, energy economist Philip Verleger, a leading authority on energy commodity markets including oil, natural gas and electricity, points out that past impaired financial condition of these companies led to a situation where banks cut lending to almost all firms in the energy sector in 2002, constraining their ability to build up stocks of crude oil.

California's 13 major refiners control 97 percent of the wholesale market for gasoline in California. In the past eight years:

- Ten significant independent oil refiners have closed;
- The major oil companies' share of the California gasoline market have climbed from a dominant 80% in 1995 to an overwhelming 97% today;
- West Coast oil company profits have surged – to become the highest in the nation; and
- Refinery profit margins are now the highest in the U.S., according to the Energy Information Administration and the California Energy Commission.⁸

Since 1995, ten significant independent refiners have closed: Anchor Refining Company; Tricor Refining, LLC; Greka Energy Corp; Paramount Petroleum Corp.; Ten By Inc.; World Oil Company; GoldenBear Oil Specialites; HuntwayRefining Company; Pacific Refining Company; and Powerine Oil Company.⁹

The gasoline industry in California is more concentrated and vertically integrated than in other key refining areas of the United States. The Consumer Federation of America states,

“A wave of mergers in the industry has resulted in a level of concentration that creates the basis for business behaviors and strategies that can exploit market power. Several major mergers between vertically integrated companies in the top tier of the oil industry (Exxon-Mobile, BP-Amoco-Arco, Chevron-Texaco, Phillips-Tosco) have pushed petroleum product markets to levels of concentration that are a serious concern.”

⁸ California Service Station and Automotive Repair Association, pg. 2

⁹ Worldwide Refining Surveys 1994-2002, Oil and Gas Journal

Below is a comparison of market shares for 1965 and 2001. (Source: California Energy Commission)

1965

<i>Retailer</i>	<i>Percent Market Share</i>
Caminol	0.80%
Coastal	0.19%
Douglas	2.02%
Fletcher	0.60%
Gold. Eagle	1.35%
Gulf	4.37%
Humble	1.08%
Mohawk	0.73%
Newhall	0.11%
Powerine	2.16%
Richfield	9.03%
Seaside	0.88%
Shell	15.91%
Signal Oil-Gas	3.91%
Soc.-Mobil	8.49%
Standard Oil of Calif.	23.44%
Sunland	0.36%
Texaco	8.21%
Tidewater	5.66%
Time	0.93%
Union	9.83%

2001

<i>Retailer</i>	<i>Percent Market Share</i>
ARCO/BP-Amoco	22.60%
ChevronTexaco (Chevron and Texaco from Equilon merged 10/9/01)	19.91%
Equilon: Shell	15.80%
ExxonMobil (merged 12/98)	9.96%
Tosco/Unocal	17.66%
Valero (Ultrimar, Beacon)	6.99%
Unbranded & Others	7.08%

California's gasoline market is less competitive than in most of the nation, according to the Attorney General. Major refiners control 90 percent of the wholesale market for gasoline in California and large oil refiners have effectively shut out independent gasoline marketers from the retail market in California's urban areas. Currently, independent marketers supply only 10 percent in California compared to 50 percent in Texas.

Vertical integration removes important potential competitors across stages of production, but also has the potential to trigger a wave of integrative mergers, rendering small independents vulnerable at any stage.¹⁰

¹⁰ Consumer Federation of America, pg 31

The Attorney General points to the closure of several independent refiners in California in 1997, followed closely by corporate mergers.

- 03/01/97: ARCO purchased Thrifty Oil and its 260 retail stations – at the time one of California’s largest independent marketers of gasoline;
- 04/01/97: Tosco bought Unocal’s marketing and refining assets.
- 05/26/99: Exxon and Mobil merged to form ExxonMobil;
- 04/13/00: BP Amoco and Arco merged to form British Petroleum;
- 04/11/01 Phillips Petroleum acquired Tosco, which became fully integrated;
- 10/09/01: Chevron and Texaco merged to form ChevronTexaco;
- 12/31/01 Valero merged with Ultramar Diamond Shamrock to become Valero Energy; and also became fully integrated; and
- 08/30/02: Conoco and Phillips Petroleum merge to become ConocoPhillips (76 In California) ¹¹

According to the Attorney General, these changes in the industry have substantially limited wholesale competition resulting in the highest refinery margins in the U.S. and higher pump prices for California motorists.

However, according to the July, 2003 special issue edition of the “International Journal of the Economics of Business: Gasoline Distribution, Price Discrimination, and Uniform Pricing”, in analyzing efforts to allow open branded supply;

“The major impact of the proposed regulations is to shift competitive pressures on wholesale prices from the station to the terminal level. As a result, differences between the delivered dealer prices of branded and unbranded gasoline should decline. For this reason, we anticipate greater dealer price increases for unbranded gasoline even than for branded gasoline with enactment of branded open supply.”

Consumer advocates dispute this and believe that prices can run up quickly because of even slight disruptions in the supply demand balance and producers are slow to react because they do not fear that others can bring product to market and steal their business. ¹²

Potential Pressures on Retailers

Retailers claim that major oil companies creating business conditions for their lessee dealers have also contributed to higher prices for consumers.

Retailers claim that the following examples illustrate the conditions dealers must operate under that have resulted in many dealer closures:

¹¹ Attorney General,

¹² Consumer Federation, pg 34

- Over the past decade branded dealers have experienced tremendous rent increases. The average rent in 1990 was \$3,000 per month. Today it is \$11,000 per month as most majors have implemented “fair market value” rent programs.
- All major oil companies, with the exception of BP “Arco”, have or intend to drop their incentive rent or price allowance programs, which were developed to help dealers compete with lower priced competition.
- Micro Zone pricing is used by all major brands throughout the metropolitan areas of California. “Zones” are as small as a street corner. A dealer of the same brand just three blocks away, can have an 8 percent per gallon price differential.
- The number of company-operated stations has increased dramatically. Chevron, Shell, ConocoPhillips (76), BP “Arco”, Valero and Mobil all have company operated stations selling at prices well below margins needed to run a successful dealer franchise in the same market areas.
- Oil companies have asked retailers to pay increased operating expenses over the past fifteen years. The following are examples of expenses passed directly to the franchise dealer:
 - Hazmat Plan annual fee;
 - Pump calibration fee;
 - Underground storage tank assessments; and
 - Credit card fees which average \$5000 per month.
- Maintenance responsibilities have increased and expenses associated with maintaining nozzle, hoses, air conditioning, refrigeration, landscaping, water systems, and even bathroom fixtures are now the dealers’ responsibility.
- All major oil companies have implemented electronic funds transfer on gasoline, rent, credit card fees, and other fees such as royalty charges. Dealers who experience drafting errors must wait for their company’s credit department to correct an improper draft, sometimes holding dealers’ funds for days or weeks.

Retailers further contend that the prominent role of profit-motivated business decisions in reducing capacity raises the concern that these decision are intended to reduce competitive market forces and secure market power for major industry players. While mergers and acquisitions or facility closings are justified by claims of efficiency gains, they have a real economic effect of reducing competition.¹³

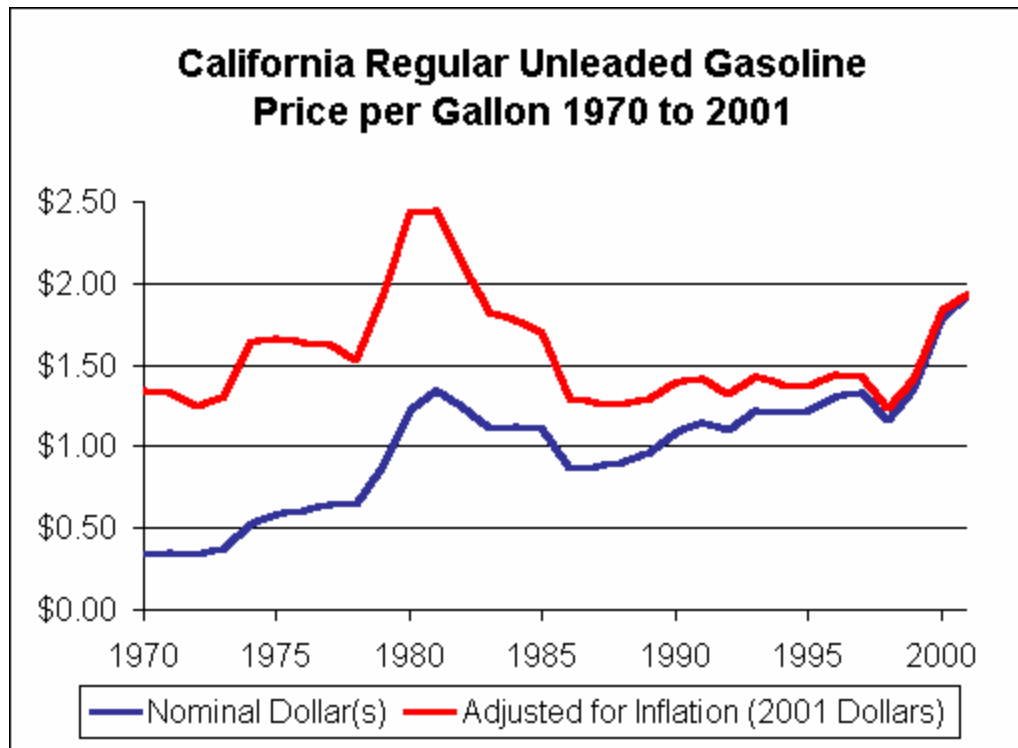
However, according to the July, 2003 special issue edition of the “International Journal of the Economics of Business: Gasoline Distribution, Price Discrimination, and Uniform Pricing”,

“The retail gasoline market is competitive. Multiple sellers, mobile consumers, symmetric information, and an absence of significant entry barriers

¹³ California Federation of America, pg. 25

combine to make the retail gasoline market in California competitively organized. The majority of individual stations are operated by independent firms with an incentive to compete against each other. The abundance of stations in California places stations within close proximity of a competing station."

Oil companies also claim that to some extent retail prices have not been excessive, and have only kept pace with inflation.



Source: California Energy Commission

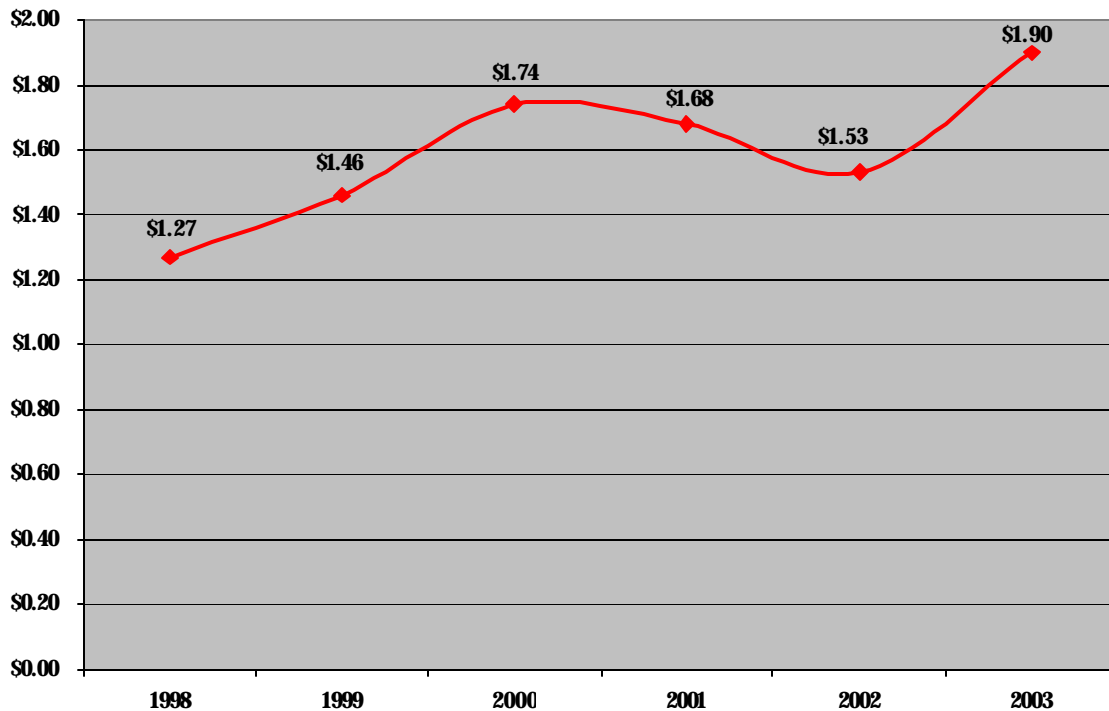
However, California Service Station and Automotive Repair Association contends that this is not true since 1998, where in California, gas prices have exceeded inflation by 150%. (Please see chart on Page 18.)

According to the California Service Station and Automotive Repair Association, gasoline prices should NOT be keeping pace with inflation but instead should be decreasing. California Service Station and Automotive Repair Association point to cost "efficiencies" claimed by the oil companies when explaining business decisions to shutdown refineries and close thousands of service stations during the past fifteen years.

According to California Service Station and Automotive Repair Association, oil companies have argued that they were simply seeking marketing and refining efficiencies to provide lower prices to the consumer. California Service Station and Automotive Repair Association states that the oil companies now have fewer stations pumping far more fuel with less liability and they now have modern refineries producing more finished gasoline per barrel of crude at even lower costs.

CSSARA states that motorists have never enjoyed the economic benefit of the "efficiencies" that were supposed to be passed onto the California consumer,

Adjusted for inflation, gasoline prices in California have increased by 150% since 1998, according to the California Energy Commission.



Source: California Energy Commission, 2003 dollars.

Documents from the mid-1990's reveal that industry officials and corporate officers were concerned about how to reduce capacity,

"If the U.S. petroleum industry doesn't reduce its refining capacity, it will never see any substantial increase in refinery profits," said a Chevron Corporation document in November 1995."¹⁴

More recent comments from oil company executives reaffirm their concern to reduce capacity,

*"[The Benicia refinery] should contribute significantly to the company's third quarter and second half results due to the favorable outlook for West Coast margins and full six months of operations."*¹⁵

The California Energy Commission found that since 1996, California petroleum production capacity has remained relatively constant, while consumer demand has grown steadily. This has resulted in the necessity of importing refined products during high use periods to meet demand. Since there are no plans for new refineries to be built in California, the state will become increasingly reliant upon out-

¹⁴ "Oil Data Show Industry Role in Shortages a Possibility," *New York Times*, June 15, 2001

¹⁵ Bill Greehey, Chairman, Valero Energy Petroleum Finance Week, 8-28-00

of-state refiners to supply gasoline or gasoline blendstocks which must be refined to California's unique clean air fuel specification standard.¹⁶

The 1973 – 1979 Gas Crisis

The Automotive Trade Organizations of California alleges that oil companies perpetrated an abuse on the motoring public during the 1973 and 1979 gasoline shortages, which were blamed on the Iranian trade embargo and an OPEC boycott. Both events resulted in California consumers waiting in long lines for gasoline at a higher price. Retailers were put on "allocation" by the major oil companies and in some months received less than 50% of their previous years gasoline sales. As a result of financial hardships, nearly one-third of the states service station population closed and many independent, non-majors were forced to close their stations forever. According to the National Petroleum news, in 1973 there were nearly 17,000 gasoline stations in California. Today there are about 9,000.

By the time these dealers were forced out of business by the oil companies, they had no money left to hire legal counsel. Very few attorneys will do pro-bono work against oil companies because their business practices are difficult to prove and they often withhold valuable information to support damage cases.

The Automotive Trade Organizations of California further alleges that during the 1973 and 1979 energy shortages, oil companies, lead by Standard Oil Company of California (Chevron) conspired with the other major oil companies to withhold supplies and drive up prices in both 1973 and 1979. The State of California (along with other states) , led by then state attorney general Evelle Younger, filed a major law suit against the oil companies referred to as MDL150, "multi district lawsuit, after the case number." Nearly 20 years later the oil companies settled for over \$300 million in an out of court settlement.

In depositions, many key employees of oil companies admitted to exchanging pricing information to Chevron. All of this was well-documented in Evelle Younger's discovery statement that was filed with the courts.

The Automotive Trade Organizations of California contends that Chevron knew they might eventually get caught, that what they were doing was illegal and that they needed a third party to collect wholesale pricing data, which is a perfectly legal practice.

It was alleged in the lawsuit that Chevron encouraged former newscaster, Dan Lundberg to start such a gasoline data survey. Today, his daughter, Trilby Lundberg still collects wholesale and retail price data and sells the information to the oil companies.

Today there is one other pricing service, referred to as "OPIS" (Oil price information services). Essentially, jobbers supply the wholesale price at the trucking refinery

¹⁶ California Energy Commission, I-10

"rack" for each major oil company. This information is updated on sometimes an hourly basis and is sold via hardcopies and the Internet.

Competition

Automotive Trade Organizations of California further contends that the gasoline market is very dysfunctional and works to the advantage of the oil companies, rather than consumers. San Diego County Supervisor, Bill Horn seems to share that opinion:

"I am an advocate of free enterprise and the market place, and on a business level I have to admire the oil companies' commercial success. However as an elected representative of San Diego County residents and consumers, I believe we have to seek correction in a market that no longer exhibits any true competition."

In a 1998 ruling, a Florida judge noted that "Exxon secretly divided its dealers into 'keepers' and 'non-keepers' and internally recognized that its pricing practices were driving the 'non-keepers' out of business."

Currently 16 states have gasoline marketing laws on the books. According to the U.S Energy Information Administration, all of these states had lower gas prices than California in 2002 (excluding all taxes). The states are: Alabama, Connecticut, Delaware, Florida, Maryland, Massachusetts, Missouri, Nevada, New Jersey, North Carolina, Rhode Island, South Carolina, Tennessee, Utah, West Virginia and Wisconsin. Many of these states do not have refineries.

Both Texas and New York have similar gasoline reformulation requirements, yet both states had lower gas prices in 2002 than California.

VI. CARB Gasoline, MTBE, and transition to summer gasoline in California

In 1996, the California Air Resources Board required a special clean-burning gasoline better known as CARB. The reformulation requirements include more stringent and exacting requirements for the summer months.¹⁷

The California Air Resources Board estimates that CARB reformulation requirements have added an additional four to six cents per gallon to refinery costs. It should also be noted that no other clean air requirement for motor vehicles has had such an immediate and vast effect on air quality. The implementation of CARB requirements had the equivalent air quality affect of taking 3.5 million cars off the road.

The California Air Resources Board also contends that many states have a similar reformulation requirement of their own and that all states are finding themselves in unique positions relative to air quality requirements.

¹⁷ Attorney General, 5

Californians have made it clear that they support efforts to reduce emissions. A May, 2000 poll by the California Zero-Emission Vehicle (ZEV) Alliance found that 83 percent of poll respondents identified air quality as a serious problem. The poll also found that 64 percent supports the California Air Resources Board's ZEV Program. Clean burning fuel is clearly important to California families.

According to the Energy Information Administration, the national average price (excluding California) for regular reformulated gasoline between January 1, 1995 and August 18, 2003 was \$1.26 per gallon. Alternatively, California families and businesses paid \$1.44 per gallon during the same period of time. The difference between the EIA's national average price (w/o California) and EIA's California's average price for gasoline is 18 cents.

The California Service Station and Automotive Repair Association contends that equalized for different tax rates, the post-tax price difference between other states and California for regular reformulated gasoline is 9.6 cents per gallon. Annual consumption of gasoline in California exceeds 15 billion gallons each year. This means California families and businesses have paid approximately \$1.44 billion more than other states for reformulated fuel each year since 1995.

Beginning in the winter of 1992-93, methyl tertiary-butyl ether (MTBE) was begun to be used in gasoline to help reduce emissions of carbon monoxide. MTBE was the oxygenate of choice because MTBE is a byproduct of the refining process and made the most economic sense for the industry. The oil industry supported the use of MTBE as an oxygenate.

Oxygenates were later mandated for use in all federal reformulated gasoline (RFG) regions of the US to help reduce air pollution.¹⁸ Since 1995, California refiners have had to import MTBE. When California refiners import gasoline from out-of-state, they incur additional shipping costs on top of all other production and distribution costs.

Federal RFG regulations require a minimum amount of oxygen in the gasoline regardless of California law meaning that more than 80 percent of the gasoline must contain some type of oxygenate, primarily MTBE or ethanol.¹⁹

In response to growing evidence regarding MTBE contaminating California's water resources, Governor Davis issued an executive order eliminating MTBE from California's gasoline by December 31, 2002. With the concern that phasing out MTBE would create severe supply problems, Governor Davis decided to delay the phase out until January, 2004.

Governor Davis also asked the federal government to eliminate the oxygenate requirement for California. Governor Davis claimed that California fuel meets clean air requirements without the need for an oxygenate. However, the federal

¹⁸ California Energy Commission, III-1

¹⁹ California Energy Commission, III-1

government refused to comply with the request and in essence required California to shift from MTBE to Ethanol.

The MTBE phase-out resulted in a shift of independent marketer demand resulting in primary suppliers struggling to maintain consistently adequate supplies of gasoline to their customers. This appears to have contributed to a price increase for unbranded gasoline in both Northern and Southern California.²⁰

A difficulty that developed when transitioning away from MTBE was the resulting shift in new supply relationships and potential supply problems that may have resulted from ethanol distribution challenges.

Phasing out MTBE has also led to changes in terminal operations, such as blending ethanol at terminals rather than at refineries. Terminals must now store ethanol separately in segregated storage tanks.

Nevertheless, The Attorney General's Task Force concluded that wholesale price for CARB gasoline has averaged only four cents per gallon more than conventional gasoline. This seems in conflict with oil company claims that California is unique because there are more stringent cleaner-burning gasoline requirements that make it more expensive to produce.

Summer and Winter

Gasoline prices normally increase around March as refiners switch from winter blends to summer blends.

"Gasoline specifications in California become tighter during the ozone season to improve the emission performance of automobiles... to ensure that storage tanks and retail service stations are complying with the lower limits by the time of the ozone season, the production of low volatility gasoline usually begins prior to early spring in Southern California and spring in Northern California."²¹ Summer gasoline contains more expensive ingredients and generally costs 5 cents more per gallon to produce. *Fuel terminals and storage facilities try to empty their large tanks of winter gasoline before switching over to summer blends, making March a time of temporarily low inventories, and leaving the market vulnerable to price increases if supplies are disrupted.*²²

Because, consumer demand for gasoline is at a low during the winter, refiners often take processing units out of service during late fall or early winter to perform maintenance before the summer driving season begins. ("Turnarounds")²³ *These "turnarounds" are planned events; refiners build gasoline inventories or purchase additional supplies to get them past the time when their refineries are not producing.*

²⁰ California Energy Commission, ES - 2

²¹ California Energy Commission

²² California Energy Commission, ES - 2

²³ California Energy Commission, ES - 2

This year, gasoline supplies became tighter and prices increased as some of those turnarounds took longer than expected. ²⁴

According to the California Energy Commission these supply shocks are unique to California. Under these scenarios, petroleum product production falls short of expectations. Prices rise to ration the limited supplies, and to provide an incentive to industry to increase out-of-state sources of supply. ²⁵

Gasoline Production and Distribution in California

The Attorney General found that California's distribution system is divided into three segments:

- 1) Approximately 70 percent of California retail stations are operated under station lease agreements with a major California refiner. These have been the result of independent retailers such as Thrifty leaving the California market. These leases are usually based upon supply agreements that require the lessee dealer to purchase their gasoline supplies exclusively from their branded refiner.²⁶
- 2) Fifteen percent of the stations are both owned and operated by refiners and the trend is increasing.
- 3) The remaining fifteen percent are owned and operated by independent dealers, known as "open dealers," or "jobbers", with the majority entering into "branding arrangements" with a refiner or a branded jobber that allow them to sell a refiner's particular brand. Jobbers are intermediaries who market branded and unbranded gasoline.²⁷ Jobbers tend to be located outside metropolitan areas, while the vast majority of lessee-dealers are located within metropolitan areas because they have an exclusive supply agreement with refiners.

Only six refiners produce 90 percent of the gasoline in the state, they also supply approximately 85 percent of it pursuant to contracts that specify wholesale prices to dealers. ²⁸ Refiners sell branded gasoline to lessee-dealers at Dealer Tank Wagon (DTW) price. While the same refiner may have many different DTW prices in a single metropolitan area, dealers are not permitted to purchase gasoline from any source other than the refiner from which they bought their franchise.

Zone Pricing

According to the Attorney General, zone pricing is a gasoline marketing practice by which refiners establish different DTW prices among "zones" within the same

²⁴ California Energy Commission, ES - 2

²⁵ California Energy Commission, I-9

²⁶ Attorney General, pg. 24

²⁷ Attorney General, pg. 24

²⁸ Attorney General, pg. 25

geographic area due to the nature of competition in each area.²⁹ Refiners currently establish numerous price zones within a large city, even though the entire city is served from a single terminal and the cost of delivery to dealers in each zone is nearly identical.

The oil industry has contended that zone pricing is an effective means of responding to the market. It is not discriminatory or predatory pricing.

Many states have found that zone pricing is a form of predatory pricing and have enacted legislation to limit this activity.

The chart below was provided by the California Service Station and Automotive Repair Association.

Significant Gasoline Marketing Laws in the United States

State	Effect of Petroleum Marketing Law	Average Gasoline Price Per Gallon in 2002 (adjusted for taxes)
CALIFORNIA	NONE	\$1.00
Alabama	Forbids predatory pricing designed to drive out competition	\$0.88
Connecticut	Limits market control by integrated oil companies.	\$0.93
Delaware	Limits market control by integrated oil companies.	\$0.89
Florida	Forbids predatory pricing designed to drive out competition	\$0.89
Maryland	Limits market control by integrated oil companies.	\$0.90
Massachusetts	Forbids predatory pricing designed to drive out competition	\$0.95
Missouri	Forbids predatory pricing designed to drive out competition	\$0.91
Nevada	Limits market control by integrated oil companies.	\$0.98
New Jersey	Makes it illegal to sell at any price below net cost plus selling expenses and bans the use of lotteries or prizes in connection with sales of motor fuels.	\$0.93
North Carolina	Forbids predatory pricing designed to drive out competition	\$0.86
Rhode Island	Forbids predatory pricing designed to drive out competition	\$0.91
South Carolina	Forbids predatory pricing designed to drive out competition	\$0.87
Tennessee	Forbids predatory pricing designed to drive out competition	\$0.85
Utah	Forbids predatory pricing designed to drive out competition	\$0.90
West Virginia	Limits market control by integrated oil companies.	\$0.91
Wisconsin	Sets a minimum 6 percent markup on the price of gasoline.	\$0.94

²⁹ Attorney General, pg. 26

VIII. Differences Between California Prices and the Rest of the Nation

The California Service Station and Automotive Repair Association states that in the eight years between January 1, 1995 and December 31, 2002, the loss of disposable income to California families and businesses due to higher prices for fuel, after ALL adjustments for taxes and reformulated fuels, is approximately \$11.5 billion.

According to Attorney General Bill Lockyer in his May 2000 *Report on Gasoline Pricing in California*, "California's businesses and consumers regularly pay among the highest gasoline prices in the nation . . . These high prices erode the competitiveness of California's industries and reduce the real income of our citizens. The confluence of factors that support high gasoline prices has been a long time in the making, and it is unrealistic to suggest there is a quick fix to our problem. Even so, it is important to begin taking the steps necessary to increase competitiveness in California gasoline markets, increase gasoline supplies, and further conserve fuel."

Weekly U.S. Retail Gasoline Prices, Regular Grade **Dollars per gallon, including all taxes**

	08/04/03	08/11/03	08/18/03	Change from week ago	Change from year ago
U. S.	1.536	1.571	1.627	0.056	0.235
East Coast	1.501	1.537	1.575	0.038	0.208
New England	1.545	1.572	1.602	0.030	0.161
Central Atlantic	1.519	1.547	1.586	0.039	0.161
Lower Atlantic	1.475	1.520	1.559	0.039	0.257
Midwest	1.540	1.567	1.596	0.029	0.222
Gulf Coast	1.447	1.486	1.519	0.033	0.210
Rocky Mountain	1.582	1.621	1.649	0.028	0.200
West Coast	1.672	1.714	1.887	0.173	0.357
States					
California	1.703	1.743	1.920	0.177	0.339
Colorado	1.539	1.576	1.607	0.031	0.170
Florida	1.530	1.571	1.610	0.039	NA
Massachusetts	1.533	1.559	1.585	0.026	NA
Minnesota	1.632	1.591	1.601	0.010	0.210
New York	1.598	1.622	1.665	0.043	0.151
Ohio	1.500	1.538	1.604	0.066	NA
Texas	1.442	1.474	1.504	0.030	0.196
Washington	1.612	1.663	1.824	0.161	NA

Cities

Boston	1.535	1.563	1.585	0.022	NA
Chicago	1.610	1.630	1.673	0.043	0.205
Cleveland	1.508	1.563	1.624	0.061	NA
Denver	1.540	1.573	1.608	0.035	0.173
Houston	1.417	1.452	1.494	0.042	0.195
Los Angeles	1.673	1.721	1.922	0.201	0.387
Miami	1.568	1.590	1.631	0.041	NA
New York City	1.530	1.561	1.600	0.039	0.125
San Francisco	1.787	1.827	2.007	0.180	0.348
Seattle	1.596	1.632	1.817	0.185	NA

Source: U.S. Department of Energy, Energy Information Administration

In 1999, prices in California averaged 21 cents more per gallon than the rest of the U.S. and the gap has continued to widen annually. Findings by the Attorney General revealed that gasoline prices in California were higher during 1999 than in any state other than Hawaii and Nevada. In addition, California experienced significant, unprecedented price “spikes” during 1999 after periods of refinery outages that reduced gasoline supplies.³⁰

April of 2003, gasoline in California was the most expensive in the country, selling for 42 cents per gallon more than the national average. California gasoline is more expensive than anywhere in the country, and averaged 20 cents higher than the national average between 2000-2002. In the first 14 weeks of 2003, the price of gasoline has averaged 31 cents higher than the national average.³¹

While there are 18 other states that are required by the U.S. Environmental Protection Agency to utilize reformulated gasoline (RFG), California still pays an average of 16 cents more per gallon according to the Energy Information Administration.

These costs calculate to a combined \$5.8 billion more that Californians have paid for gasoline since June 2000.

Oil companies often argue that one of the reasons gasoline is high in California is our tax structure. The California Energy Commission published a report in July, 2002. The report shows that California has the third highest tax per gallon in the U.S. at 50.4 cents per gallon. The U.S. average is 42.0 cents per gallon. California taxes in July, 2002 were 8.4 cents higher than the U.S. average.

However, Automotive Trade Organizations of California states that after January 1, 2003 the major refiners in the state all switched to ethanol blend gasoline, which lowers the federal tax from 18.4 cents per gallon to 15.4 cents per gallon, or a three cent decrease in federal tax for using Ethanol.

³⁰ California State Attorney General Bill Lockyer, Report on Gasoline Pricing in California,

³¹ U.S. Energy Information Administration

Automotive Trade Organizations of California states that on or about January 1, 2003 the oil companies lowered the federal tax on invoices to dealers and at the same time, increased their wholesale gasoline prices to dealers by the same amount.

Secondly, because in California the more we pay per gallon, the higher the tax, taxes are higher in California. However, it stands to reason if the oil companies charge more for gasoline in California than the rest of the country, adjusted California average gasoline price to the U.S. average, our sales tax would be 1.0 to 1.5 cents per gallon lower than current rates.

In other words, if you adjust for the reduction in the federal tax, (effective January 1, 2003) 3 cents per gallon and reduce our progressive sales tax differential to the national average, adjusted, California tax per gallon is 3 to 5 cents higher than the National average. (Please see Appendix #3.)

Automotive Trade Organizations of California concludes that taxes then, do not explain the huge differential Californians pay for a gallon of gasoline.

The California Service Station and Automotive Repair Association states that California taxes are not to blame for our high prices. When comparing the cost of gasoline from one state to another, without regard to taxes, California still pays much more than the rest of the nation. (Please see Appendix #4.)

Appendix #1

Excerpts from Senate Energy, Utilities & Communications Committee analysis of SB 304 (Morrow)

Despite being home to a number of oil refineries, Californians can't seem to shake high gasoline prices. In 1996, California gasoline prices spiked from \$1.15/gal to \$1.47. In 1999, gasoline prices spiked again, rising as much as \$0.50/gal higher than the rest of the nation. Earlier this year, gas prices spiked yet again, this time from \$1.57/gal to \$2.15/gal. Each of these price spikes prompted public outcries, legislative responses, and, in 1999, an investigation by the Attorney General.

The current concerns over gasoline prices prompted Governor Davis to order an investigation by the California Energy Commission (CEC). That investigation noted gasoline prices climbed 36% from the beginning of the year through March 17, which if sustained will cost consumers more than \$20 million per day. The cause of the price increases was attributed to large increases in the price of oil due to uncertainty about the U.S.-Iraq war, an oil strike in Venezuela, and a cold winter in the eastern U.S. Refiners also switched from a winter gas formula to a summer formula, which is typically more expensive to produce and, during the switchover, temporarily tightens supplies. Additional gasoline demand in Phoenix reduced California supplies further, as did the move to phase-out the use of MTBE.

Current Market Structure: California has 16 refiners, 6 of which control 86% of the refining capacity in the state. The largest refiners are vertically integrated, owning crude oil supplies, refining operations, and retail distributors. About 15% of all California gas stations are owned and operated by dealers who are independent from refiners, 15% are owned and operated (O&O) by the refiner, and 70% are franchisees of the refiners. All franchisees are contractually obligated to obtain their gasoline from the refiner at prices established by the refiner, making the franchisee dependent on his competitor to provide him with his product.

Attorney General Report: In 1999, the Attorney General opened an investigation into the activities of the refiners to determine whether they were operating in a non-competitive manner in violation of California and/or federal law. This investigation is ongoing, but has yet to result in any prosecutions.

The Attorney General also convened a Task Force on gasoline pricing. A summary of the Task Force discussion was published in May 2000 in a report entitled "Report on Gasoline Pricing in California." A preliminary report provided to the Attorney General noted three contributing factors to California's relatively high gas prices:

- A relative lack of competition in California's gasoline refining and marketing industry.
- Supply constraints related to California's unique cleaner burning gasoline requirement;
- Somewhat higher state taxes.

In a recent update, the Attorney General suggested considering the following proposals:

- Creating a strategic fuel reserve;
- Increasing fuel economy standards and encouraging non-gasoline based technology;
- Enabling gas dealers to shop for the best wholesale prices;
- Examining ways to import more fuel into the state.

California vs. The Other 49 States: Since the mid-1990's, California's gasoline has been generally more expensive than gas found in other states and that difference has been more pronounced during price spikes. There are two major causes. The first is that in 1996, California switched to a unique type of gasoline that burns cleaner than gas sold in most other states. Few non-California refiners produce this type of gasoline, making it difficult for additional supplies to be imported into California. When prices in California rise, the non-California refiners that choose not to produce "California gas" aren't able to ship gasoline in to keep prices down.

The second major cause is the increasing consolidation among refiners. In 1980, there were 35 refiners operating in California. By 1990, only 25 refiners were operating and by 1998, that number had dwindled to 16. Accompanying the consolidation of refiners was an increase in vertical integration, so now 85% of all retail service stations are owned, operated, or controlled by refiners.

A relatively constant factor that keeps California gasoline more expensive is gasoline taxes, which are on average five cents higher than the other states. However, higher taxes contribute a relatively small amount to California's price discrepancy with other states - in fact, California's gasoline taxes are actually lower than those in Nevada.

Oil Company Profitability: If the allegations of anti-competitive behavior and price gouging are true, then the profitability of the oil companies should be high. It isn't particularly useful to examine the return on equity (ROE) for the oil companies, since their California refining and marketing operations are a relatively small part of their overall business. In any event, the ROE's for the major oil companies are unremarkable, comparable to that of the major utilities, notwithstanding ExxonMobil's recent record first quarter profit of \$7 billion.

The only publicly available measure of profitability for the California operations of the major oil companies is refinery cost and profit data kept by the CEC. By determining the average wholesale price and subtracting from it the price of crude oil, the CEC determines how much is left to pay for the cost of refining and to provide the refiner with a profit, known as the refinery margin. This is a rough calculation based on aggregated data that doesn't incorporate all actual wholesale transactions.

	2002	2001	2000	1999	1998
Refinery Margin/gal	\$0.40	\$0.58	\$0.42	\$0.40	\$0.32

In March 2003, the refinery margin averaged \$0.63/gal and in the first two weeks of April it was \$0.68/gal. This is an unusually high margin that many wouldn't expect to find in a truly competitive market.

Appendix #2

In its "A Primer for Gasoline Prices", the Energy Information Administration addresses why it believes California prices are higher and more variable than other states. Below is an excerpt:

Why are California gasoline prices higher and more variable than others?

The State of California operates its own reformulated gasoline program with more stringent requirements than Federally-mandated clean gasolines. In addition to the higher cost of cleaner fuel, there is a combined State and local sales and use tax of 7.25 percent on top of an 18.4 cent-per-gallon Federal excise tax and an 18.0 cent-per-gallon State excise tax.

California prices are more variable than others because there are relatively few supply sources of its unique blend of gasoline outside the State of California refineries need to be running near their fullest capabilities in order to meet the State's fuel demands. If more than one of its refineries experiences operating difficulties at the same time, California's gasoline supply becomes very tight and prices soar. Supplies could be obtained from the Gulf Coast and foreign refineries; however, California's substantial distance from those refineries is such that any unusual increase in demand or reduction in supply results in a large price response in the market before relief supplies can be delivered. The farther away the necessary relief supplies are, the higher and longer the price spike will be.

Additionally, California's recent electricity crisis has created gasoline supply concerns, as refineries and pipelines could be impacted during power interruptions.

Appendix #3

Gasoline Taxes by State 2002

(Source: [American Petroleum Institute](#))

State	State Excise	Other State Taxes	Total State Taxes	Total Federal & State Taxes
Alabama	16	5	21	39.4
Alaska	8		8	26.4
Arizona	18	1	19	37.4
Arkansas	21.5	0.2	21.7	40.1
California	18	14	32	50.4
Colorado	22		22	40.4
Connecticut	25	4.7	29.7	48.1
Delaware	23		23	41.4
Dist. of Columbia	20		20	38.4
Florida	13.6	16	29.6	48
Georgia	7.5	4.7	12.2	30.6
Hawaii	16	19.1	35.1	53.5
Idaho	25		25	43.4
Illinois	19	11	30	48.4
Indiana	15	3.1	18.1	36.5
Iowa	20.1	1	21.1	39.5
Kansas	23	1	24	42.4
Kentucky	15	6.4	21.4	39.8
Louisiana	20		20	38.4
Maine	22	1.5	23.5	41.9
Maryland	23.5		23.5	41.9
Massachusetts	21	0.5	21.5	39.9
Michigan	19	7.2	26.2	44.6
Minnesota	20		20	38.4
Mississippi	18	0.8	18.8	37.2
Missouri	17		17	35.4
Montana	27	0.8	27.8	46.2
Nebraska	24.5	0.9	25.4	43.8
Nevada	23	10.3	33.3	51.7
New Hampshire	18	2.6	20.6	39
New Jersey	10.5	4	14.5	32.9
New Mexico	17	1	18	36.4
New York	8	22.3	30.3	48.7
North Carolina	22.1	0.3	22.4	40.8
North Dakota	21		21	39.4
Ohio	22		22	40.4
Oklahoma	16	1	17	35.4
Oregon	24		24	42.4
Pennsylvania	12	14.7	26.7	45.1
Rhode Island	27	4	31	49.4
South Carolina	16	0.8	16.8	35.2

South Dakota	22	2	24	42.4
Tennessee	20	1.4	21.4	39.8
Texas	20		20	38.4
Utah	24.5		24.5	42.9
Vermont	19	1	20	38.4
Virginia	17.5	1.4	18.9	37.3
Washington	23		23	41.4
West Virginia	20.5	4.9	25.4	43.8
Wisconsin	28.1	3	31.1	49.5
Wyoming	13	1	14	32.4
U.S. Average	17.9	5.7	23.6	42

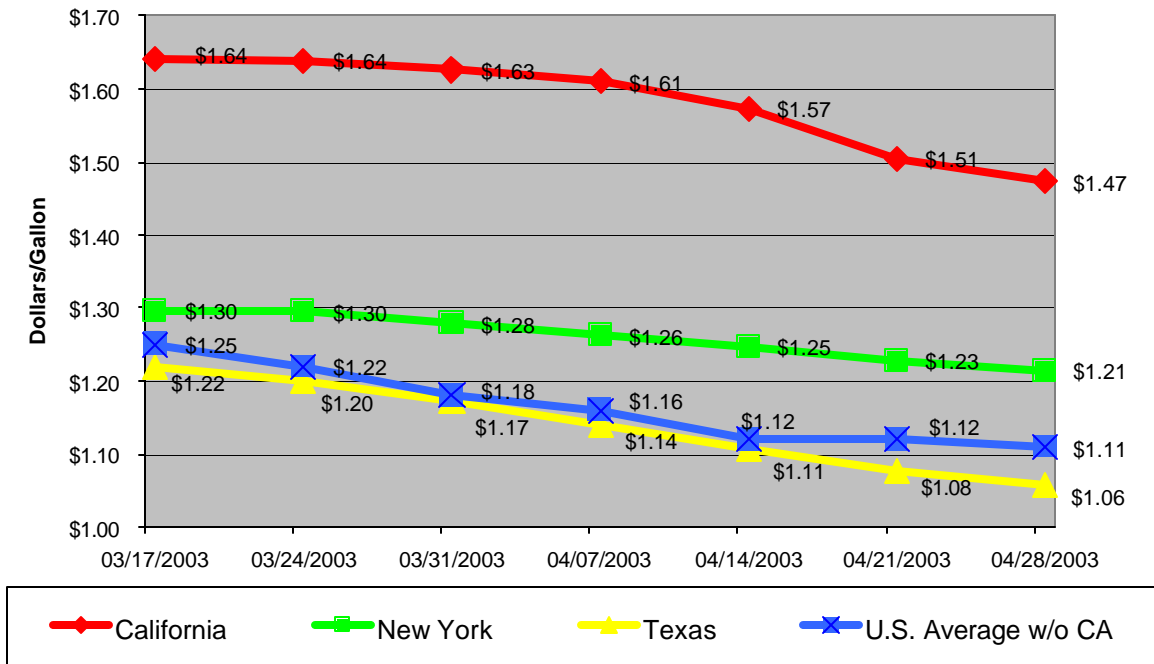
Source: [Historical Trends in Motor Gasoline Taxes, 1918-2002](#)
from the [American Petroleum Institute](#)

- a. State excise taxes represent rates effective as of July 2002.
- b. Largely excludes local taxes, which are estimated to average approximately 2 cents per gallon nationwide. However, some local county taxes in Alabama, California, Florida, Hawaii, Nevada, New York, and Virginia are included. Includes state sales taxes, gross receipts taxes, and underground storage tank taxes. State sales taxes, expressed in cents per gallon, are based on selected city average retail gasoline prices as of April 1998. See notes to tax tables for individual states.
- c. Includes 18.3 cents per gallon federal excise tax and volume-weighted average U.S. total state taxes.
- d. Represents the average of state tax rates multiplied by state gasoline consumption records.

Sources: Petroleum Institute summaries of "State Motor Fuel Tax Rates," and reports on "Nationwide and State-by-State Motor Fuel Taxes"

Appendix #4

After Tax Adjustments California, Pays \$0.36 More Per Gallon Than U.S. Average

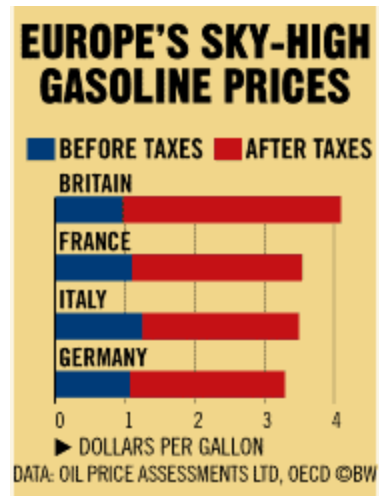


Source: California Service Station and Automotive Repair Association

According to the American Petroleum Institute, California's taxation rate for gasoline is at 50 cents per gallon and the national average is 42 cents per gallon. California Service Station and Automotive Repair Association states that if one were to believe that California's higher taxes are the reason for higher fuel prices than a simple calculation would show that the national average price for reformulated gasoline is only 8.4 cents less than the California average price. The Energy Information Administration data shows the national average of other states that use reformulated gasoline is 18 cents per gallon less than California. After-tax adjustments, California families and businesses still pay almost 10 cents more per gallon than other states using reformulated gasoline. California Service Station and Automotive Repair Association believes that taxes are NOT the issue.

Appendix #5

Below is a comparison of prices in Europe. In Europe, fuel taxes are much higher, and consequently, gasoline prices are twice the price of gasoline in California.



Source: BusinessWeek, September 25, 2000

In 2000, in the UK, France, Italy and Germany, the before-tax price for gasoline was near \$1.10 US. After taxes, prices ranged from roughly \$3.25 to \$4.00.

Appendix #6

The California Independent Oil Marketers' Association submitted the following for consideration:

The volatile conditions of the California fuels market and the significant regulatory expenses encountered in providing wholesale and retail fuels have put the independent fuel marketer in a very precarious position. Marketers, also known as "jobbers", exist on the price margin of products they sell or deliver. In situations driven by unpredictable and steep price swings, the ability to accurately plan a business is greatly complicated, as is the ability to make a sustainable profit. And, when facing ever-increasing costs of doing business, it is particularly difficult to make plans for significant capital expenditures. These are the market conditions that currently exist.

The independent oil marketer class of trade is a vital element in providing consumers with choice and competition for petroleum and other products. They serve agriculture, local governments, school districts, emergency services, construction, heavy and light industry, hospitals, as well as retail outlets. This is a critical time for CIOMA members. The legislative and regulatory decisions made in the near future will determine if California retains a vigorous independent petroleum market sector, preserving the competition they bring to the California fuels market and the service they provide to many critical elements of the California economy.

Fuel Price and Supply – The travails of the West Coast market are well documented. Due to its isolation, resulting both from physical detachment and fuel specification conditions, the market must rely on its own refining and transportation infrastructure to meet ever-increasing demand. As with the rest of the US, no significant additions to refining capacity have occurred recently. These circumstances create a tight market that fluctuates quickly and strongly if the right balance between supply and demand is not maintained. Here are some CIOMA observations regarding fuel price and supply:

- CIOMA does not generally support market-intrusion legislation such as price control, subsidies, or other dictates interfering with the competitive forces at work in the marketplace.
- CIOMA is very concerned about the closed nature of fuel supply in California. Some actions we have advocated in the past include:
 - ♦ Temporary elimination of the state portion of the fuels sales tax when state prices significantly exceed federal averages, or wholesale prices increase significantly over a short period of time.
 - ♦ Broaden the authority of the Energy Commission to declare a fuel emergency and allow temporary sales of non CARB-spec fuels.
 - ♦ Provide fast-track regulatory programs for increasing refinery capacity or permitting of new refineries.
 - ♦ Provide tax and other incentives to refiners, especially small independent refiners, so that they are able to upgrade in meeting new fuel specifications.

- ♦ Insure that state and federal fuel specifications are completely equivalent in the future so that out-of-state supplies can be marketed in California without bias.
- Mergers and Acquisitions – CIOMA is concerned that the continuing compression of major oil companies will create concentration of ownership where insufficient competitive forces will exist to assure a robust market. In very general terms, the following are CIOMA discussion points on this issue:
 - ♦ When divestiture of assets is required as part of a merger or acquisition, assets should be divested to companies not currently in the California market, and should go to companies who have resources sufficient to increase volume of products for sale in the state.
 - ♦ When brand changes occur as a result of mergers, dealers and marketers of the purchased-company brand should be protected so that they do not lose value invested and built up in their stations as they change brands.
 - ♦ Wholesalers should have protections so that they may pursue alternative supplies, without penalty, if new contracts change their previous supply agreements.
 - ♦ For CIOMA members, unbranded supply is critical. As mergers and acquisitions occur, the State should become involved in the approval process to assist in assuring that no reduction in unbranded supply occurs, and if possible leverage increased production of unbranded fuel supplies.

Unbranded Fuels - As independent fuel marketers, it is critical that a stable and affordable supply of ‘unbranded’ fuels be available. Unbranded supply is fuel that does not carry a specific brand designation (i.e. Chevron, Arco, Mobil, Unocal, etc.) Marketers may develop their own brand presence (Rotten Robbins, New West and USA are some of the more common independent brands) or they may supply “mom and pop” unbranded service stations. More importantly, unbranded fuels are the life-blood of small-volume bulk consumers such as school districts, police and fire protection agencies, emergency services, local and state government, agriculture, hospitals, construction and industry. These consumers are very price sensitive and cannot afford the price premium attached to branded supply.

Unbranded supply has become an increasingly important issue. When fuel supplies become tight – an increasingly common condition - unbranded supply is the first to feel the effects. This is because the major oil companies provide 98% of fuels in the state, and those companies make sure that their branded/owner-operated stations get first priority. When this occurs, unbranded supplies may be physically reduced by limiting supply at pick-up points (called “racks”), or through price. When wholesale price of unbranded fuels exceeds wholesale price of branded supplies a condition called “inversion” transpires. Several times over the last few years the wholesale price of unbranded fuel was HIGHER than the street retail (posted station prices) of branded, direct-delivered fuel. The duration and intensity of these inversions have become more severe.

Unbranded fuel is typically the “price leader” in low cost fuels. If the supply of unbranded fuel decreases, it will have a negative, upward effect on state fuel prices.

Lack of supply also depletes fuels critical to the survival of the independent oil marketer, and to their customer base - the school districts, emergency services, local and state government, agriculture, hospitals, construction and industrial consumers. Another negative consequence is that customers are impacted by the wild gyrations of the fuels market and have to make adjustments in their supply budgets. A school district, for example, has an annual allocation for bus fuel. If prices increase significantly, choices must be made in continuing all routes, or taking money from other programs to make up the deficit. The worst-case scenario is that supplies will become unavailable.

CIOMA is actively engaged in the issues surrounding unbranded supply:

- CIOMA sponsored a measure that requires the California Energy Commission to track supply volumes and prices of unbranded fuels. It also allows CEC to monitor import and export of fuels into and out of California.
- As noted earlier, CIOMA is concerned that the mergers and acquisitions occurring among the major oil companies is creating a “locked” market where fewer and fewer major oil companies are participating. We believe the Federal Trade Commission and the state Attorney General should closely evaluate proposed mergers/acquisitions with special attention on how combining will affect unbranded supply. Wherever possible, these agencies should promote and/or require conditions that will lead to increased production of unbranded supply.
- CIOMA will participate in the evaluation of supply reserves. There may be market-driven ideas that hold merit in assuring adequate supplies through a set-aside program for unbranded fuels.

Appendix #7

IX. Legislative History

AB 2076 (Shelley), Chapter 936, Statutes of 2000, required the CEC to examine the feasibility of operating a strategic gasoline reserve to buffer the state from any temporary gasoline supply disruptions. The bill also required the CEC to develop recommendations for reducing California's petroleum independence. The CEC recently issued the report.

AB 2098 (Migden), Chapter 963, Statutes of 2000, required the CEC to examine the feasibility of building a pipeline from the Gulf Coast to California. The CEC expects to issue this report in the next few months.

HR 58 (Sweeney) 1998 -- Resolution asking for official investigations into predatory pricing and redlining practices

SB 52 (Kopp) 1998 – Limited number of company-operated stations under certain conditions of market penetration – Failed Passage

SB 404 (Peace) 1998 – Allowed for branded open-supply – Failed Passage

SB 123 (Peace) 1999 -- Allowed for branded open-supply – Failed Passage

Appendix #8

X. Current Legislation

AB 146 (Kehoe) allows franchisees to shop for their gasoline at any wholesale outlet operated by the franchisor via a mechanism, known as "branded open supply". AB 146 is similar to SB 123 (Peace), 1999, which failed passage in the Assembly Utilities and Commerce Committee. AB 146 is currently pending in Assembly Business and Professions Committee.

AB 1340 (Kehoe) requires certain information to be reported to the California Energy Commission. This bill is pending in Senate Appropriations Committee.

SB 304 (Morrow) prohibits refiners of motor fuels from converting service stations owned by independent dealers to company-operated service stations, after January 1, 2005. The bill also prohibits refiners from engaging in various pricing and delivery practices. This bill is pending in Senate Rules Committee.